# BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

## OPINIONS OF THE COURTS BELOW

The District Court rendered no opinion. The opinion of the Circuit Court of Appeals for the Sixth Circuit is printed in the first record at pages 212-217 and in the second record at pages 44-49 but is not yet officially reported.

## JURISDICTION OF THIS COURT TO GRANT THE WRITS

a. The judgments of the Circuit Court of Appeals for the Sixth Circuit, review of which is hereby sought, were entered on January 17, 1941.

b. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A. Section 347 (a) ).

c. Review is hereby sought of bankruptcy cases in the United States Circuit Court of Appeals for the Sixth Circuit in which final judgments have been rendered.

## STATEMENT OF THE CASE

The statement of the case is set forth in the Petition at pp. 2-6, and is here incorporated by reference. The following excerpt from the opinion of the Circuit Court (F. R. 212, S. R. 44) is helpful:

"Appeal No. 8718 involves two orders of the District Court, one entered February 7, 1940, and the other February 19, 1940. In the first order the court found that $1,157,000 in principal amount of the debts listed was represented by unsubordinated bonds; that the appraised value of the hotel did not exceed $550,000; that all creditors having claims inferior to the unsubordinated bonds would not be materially and adversely affected by any arrangement because their claims were without value, and ordered that such creditors should not participate in or vote upon any proposed arrangement. The court also decided that the debtors had no equity in the property, and hence had no right to participate in any proposed arrangement.

"In the order of February 19, 1940, the court ordered that an arrangement prepared by the bondholders' committee, and another proposal submitted by the representative of the second mortgagee, should be submitted to the creditors along with the arrangement proposed by the debtors. In this order the court classified the individual and unrelated debts of each appellant under the same classification."

"Appeal No. 8822 is from an order entered July 22, 1940, confirming an arrangement as modified, proposed by the bondholders' committee. The arrangement gave the benefit of the entire property to the unsubordinated bondholders. The District Court then discharged the debtors from all of their debts and liabilities except as specifically provided in the arrangement or in the order excluding such debts as are not dischargeable under the provisions of Section 17 of the Bankruptcy Act as amended."

The Circuit Court held that while it was error to submit to creditors offers other than debtors and to classify together unrelated debts of the two debtors such error

was harmless because the value of the hotel being exceeded by the amount of the lien thereon, neither debtors nor unsecured creditors could participate in any way. The court thereupon affirmed the orders in No. 8718.

The Circuit Court further held that the consent of the debtors was not required for a confirmation of an offer proposed by the creditors and therefore affirmed the order in No. 8822, except that it limited the debtors to the discharge only of those debts provided for by that arrangement (i.e., the bonds) and left the claims of other creditors undisposed of and undischarged.

## POINTS RELIED ON FOR REVERSAL

1. A proceeding under Chapter XII of the Chandler Act is in the nature of a composition, and where a secured debt is greater than the value of its security, the court cannot, *ipso facto*, hold that debtor has no claim or equity of value and can not participate in any arrangement which may be proposed.

2. In such a proceeding, where a secured debt is greater than the value of its security, the court cannot, *ipso facto*, hold that other creditors have no interest of value and no right to participate in or vote upon any arrangement which also makes provisions for their separate benefit that do not affect the secured debt.

3. In a proceeding under Chapter XII of the Chandler Act unsecured creditors are entitled to participate in an arrangement and to settle their claims with the debtor.

4. In a proceeding under Chapter XII of the Chandler Act a secured creditors' arrangements which makes no provision for unsecured creditors cannot be confirmed.

5. In a proceeding under Chapter XII of the Chandler Act no arrangement can be confirmed without the consent or acceptance of the debtor.

6. In a proceeding under Chapter XII, a bondholders' committee cannot propose an arrangement before a finding that it is a proper creditor and before leave obtained from its controlling Commission.

## ARGUMENT

### I.

### Under Chapter XII a Debtor Cannot Automatically Be Barred from Participation in Every Possible Arrangement Solely because a Secured Claim Exceeds the Value of its Security.

Petitioner Hamburger and Singer on July 5, 1939 filed their respective petitions with the lower court for a real property arrangement under Chapter XII of the Chandler Act (F. R. 13, 37). The schedules of each disclosed as assets their interest in the Belcrest Hotel which they owned jointly (F. R. 20, 51), and certain personal property. Each debtor also set forth as liabilities the claims of bondholders under the first trust mortgage on the Belcrest and the liability to Lulu E. Powers, as trustee (F. R. 17, 47). In addition thereto Hamburger scheduled certain unsecured creditors (F. R. 18) and Singer scheduled certain unsecured creditors (F. R. 48, 49), but these were in no way related to each other. Their proposed arrangement was attached to their petitions (F. R. 26-30, 56).

The district court on July 7, 1939 entered orders duly approving and accepting the petitions praying that the debtors "be afforded an opportunity to effect a real property arrangement under Chapter XII of the Chandler Act" as properly filed under said chapter (F. R. 57, 59). Subsequently, however, the district court on the petition of the trustee entered an order on February 7, 1940 finding that the value of the Belcrest property was exceeded by the amount due on the first mortgage, therefore barred both the debtors and the creditors other than first mortgage bondholders from participating in any arrangement which may be proposed in the proceeding (F. R. 67-71). It is the contention of petitioner that the district court had no authority thus to bar him and other creditors from participating by virtue solely of this finding.

**An Arrangement Under Chapter XII is a Composition**

Chapters XI and XII of the Chandler Act are outgrowths of and successors to the old bankruptcy compositions and extensions of Sections 12 and 13 and 73 and 74. (*Collier-Bender Pamphlet Edition*, 1938 *Bankruptcy Act*, page 6; *Moore's Bankruptcy Manual*, pages 631, 704). The preamble of the Act so states. (See 7 *Remington on Bankruptcy* (5th ed.) 156). These new chapters must therefore be construed and considered in the light of their history and the principles of compositions are directly applicable (*Remington* (*op. cit.*) page 156).

Arrangements of the type here involved have long been in use in England and can be found in the Bankrupt Law Consolidation Act of 1849 (12 and 13 Vict. c. 105). Similar provisions now exist under the Deeds of Arrangement Act of 1914. There also existed in England certain

provisions in the bankruptcy act itself dealing expressly with compositions and schemes of arrangement. Originally in the act of 1883 they now appear in the Bankruptcy Act of 1914. These arrangements have been construed by the English courts to mean agreements and compositions between a debtor and his creditors. (See *Tetley v. Taylor* (1853) 1 El. and Bl. 521, 540, 542, 118 Eng. Rep. 530). Similar provisions dealing with compositions and arrangements are to be found in the Canadian Bankruptcy Act of 1919, section 13, and Canadian Bankruptcy Act of 1919 as Amended (R. S. C., 1927, Ch. 11), section 11, *et seq.* These have also been construed as meaning a contract between the parties. (*Duncan, Law and Practice of Bankruptcy in Canada* (1922), page 214).

This court has also held that a "composition" partakes of a nature of a contract. (*Meyers v. International Trust Company* (1926) 273 U.S. 380, 383, 47 S. Ct. 372, 71 L. Ed. 692.)

In *Canada Southern Ry. Co. v. Gebhard,* 109 U.S. 527, this court held arrangements tantamount to composition agreements.

> "The confirmation and legalization of 'a scheme of arrangement' under such circumstances is no more than is done in bankruptcy when a 'composition' agreement with the bankrupt debtor, if assented to by the required majority of creditors, is made binding on the non-assenting minority" (636).

Finally the Chandler Act itself assimilates an arrangement to a composition. Section 14(5) of the Act provides for denial of a discharge if within six years past bankrupt has been "granted a discharge, or had a composition or *an arrangement by way of composition* . . . confirmed under this Act".

Both the district court and the Circuit Court felt that the absolute priority rule of corporate reorganization cases must control. But in view of their history and the assimilation of arrangements to compositions, the district court's order of February 7, 1940 barring debtor and unsecured creditors from further participation solely because a secured claim exceeded the value of its security, must be held erroneous. The principle which must govern in Chapter XII proceedings as well as in compositions is: Does debtor's arrangement offer creditors as much as or more than his estate will pay in a bankruptcy distribution.

> 1 *Collier on Bankruptcy* (13th ed.) page 450;
> *In re Kinnane* (D. C. Ohio, 1914) 217 Fed. 488;
> *In re Waynesboro Drug Co.* (D. C. Ga., 1907) 157 Fed. 101.

Under the Canadian Bankruptcy Act above referred to the rule as to compositions and schemes of arrangements is the same:

> "In order to be reasonable the scheme must give the creditors a greater advantage than they would have in proceedings in bankruptcy . . . "
>
> *Duncan, op. cit.*, page 220.

Likewise under the English statutes. In *Re Ashmead-Bartlett,* 18 T.L. R. 68, affd. (1901) 1 K. B. 457, C. A., the court's approval of a scheme is reported thus:

> "That subsection (of the bankruptcy act) had been held to mean that the scheme must provide something more than the creditors would receive in bankruptcy."

We have been unable to find any reported cases under Chapter XII dealing with the present problem. However, under the analogous Section 74 of the Act prior to its

amendment, it was held that an offer of a debtor to pay his creditors more than the fair market value of his estate was made in good faith. (In *re Reaney* (D. C. Pa., 1938) 37 A. B. R. (N. S.) 252). In *Re Goldstein* (D. C. La., 1938) 22 F. Supp. 270, a proposal under Section 74 was approved by the court with the following statement (271):

> "It is true that he might have offered to share a larger proportion of his salary with his creditors, but the court is not aware of any law by which this can be compelled; the other alternative being adjudication."

Although the Circuit Court of Appeals relied upon the corporate reorganization cases, this Court has, in *Case v. Los Angeles Lumber Company,* 308 U. S. 109, carefully distinguished them. It there said:

> "The statutory scheme of Sec. 77B (in those respects which are material here) is in sharp contrast to that which was provided for compositions under former Sec. 12 . . . But Sec. 77B contemplates a procedure and results not permissible under Sec. 12. Reorganizations are nowhere referred to in the statute as compositions' . . . The general view was well expressed *In Re Dutch Woodcraft Shops,* 14 F. Supp. 467, 469, 'the preservation of business enterprises must not be at the expense of creditors, and the provision of Sec. 77B should not be taken advantage of to effect what, in fact, amounts to a composition under section 12'." (308 U.S. 109, 119, footnote 14).

The foregoing clearly shows that while an insolvent debtor might be eliminated under 77B, *ipso facto,* such result is not permissible in a composition proceeding, and conversely, an insolvent may participate in a composition, but not under 77B.

**District Court Could Not Bar Debtors.**

The authorities above cited conclusively establish that the court had no power under the statute arbitrarily to bar debtors from participating in any arrangement which might be proposed. That the property securing the first mortgage indebtedness is of less value than the outstanding bonds thereon (and this is the sole basis of the lower court's decision) affords no justification for the elimination of debtor from participation in any arrangement which may be proposed in the proceeding. Despite the fact that he is to participate, his offer may nevertheless give creditors more than any reasonably expected dividend on liquidation of his estate, and will therefore be "fair and equitable". This must be determined subsequently by the court on confirmation in deciding whether or not it was "for the best interests of creditors" under Section 472 (2). In view of the fact that these proceedings may be instituted only on the debtor's petition (Sections 422, 423) and that such petition must contain an arrangement proposed by him (Section 423) and in view of the further fact that the court on July 7, 1939 approved the petition as properly filed (F. R. 57), thereby approving the proposed arrangement as proper for submission and consideration, the order arbitrarily barring debtor is a misconstruction of the statute. Even if it could be said that debtor's proposal was not one that could be legally confirmed, even if accepted, the district court would still not be justified in barring him absolutely because he could still propose, with funds obtained from outside sources, an amendment such as would make the offer fair and equitable. But of course, by the positive terms of the order of February 7, 1940, debtors were prohibited from submitting their amended offer.

The decision of the Circuit Court in applying the rigid rule of priorities of the corporate reorganization cases must result in a perversion of the language and purpose of Chapter XII. It ignores entirely the statutory provision set forth in Section 423 that a person who is insolvent may on that ground avail himself of the Act. To say that such person may voluntarily (and all proceedings must be voluntary) file a petition and pray for relief at the hands of the court, and automatically be precluded from participating in any arrangement because of that same insolvency is inconceivable. Certainly no insolvent person will file such petition if he knows that his property will immediately and summarily be taken from him, particularly where, as in the instant case, he thereby surrenders his rights and period of redemption from a mortgage foreclosure yet to be completed.

In addition to the bondholders, debtors had other creditors (F. R. 18, 48-49). Provisions were made in their proposals for the compromise and settlement of these claims, but under the order of the district court of February 7, 1940, preventing the debtors and these creditors from participating in any arrangement proposed in the proceeding, such settlement by them even with these creditors was prohibited. Debtors were thereby precluded from settling with these classes of creditors even though the proceeds for such offer came from a source other than the property securing the claims of bondholders. This, we believe, was in direct violation of Section 461 defining an arrangement as an offer making provision for the modification or alteration of the rights of creditors of each and every class. Petitioner also objected in the district court, and the Circuit Court of Appeals in its decision has agreed (S. R. 47), that he will be in the peculiar position of having obtained a discharge as to

only one class of his creditors, i. e., those provided for in the bondholders' committee's offer, and will not be discharged from any of his other debts. Nor will he be able for the next six years to file another petition in bankruptcy and obtain a discharge as to those other creditors because of the provisions of Section 14a (5). As to debtor Singer the decisions of the lower courts are even more astounding. Since he did not assume the mortgage on the Belcrest and it will be the only claim discharged, he has undergone a bankruptcy proceeding which discharges him from *no liabilities* whatsoever, and at the same time precludes him from filing another petition for the next six years.

The district court order of February 7, 1940 barring the debtors and unsecured creditors from participating was in express violation of Section 435 which requires the court to send out to creditors for their consideration copies of debtors' proposed arrangement. The natural and reasonable effect upon debtors' proposal, accompanied by such a bar order, would be to render it ineffective and stigmitize it as already rejected by the court. Acceptances of their offer under such circumstances could hardly be expected. Thus debtors' absolute right to have the offer unqualifiedly submitted to all classes of his creditors for their consideration, particularly since it contained provision for settlement not only of the bondholders' claims but of all other claims, was effectively destroyed.

The questions hereinabove discussed insofar as we have been able to determine have not been passed upon by any other courts. They should be determined by this court in order that individual debtors shall know the purposes and consequences of proceedings under Chapter XII of the Chandler Act and the meaning of the words "fair and equitable" as there used.

## II.

**Under Chapter XII Unsecured Creditors Cannot Automatically be Barred From Participation in Every Possible Arrangement Solely Because a Secured Claim Exceeds the Value of its Security.**

The district court in its order of February 7, 1940 not only barred the debtors from participation in any arrangement but similarly barred unsecured creditors.* The Circuit Court affirmed this, again basing its decision on the absolute priority rule of corporate reorganization.

As a corollary to the proposition advanced in the argument under Point I it follows that the court was without authority to preclude such creditors from participating in any arrangement which may be proposed. While it might be true that the value of the Belcrest property did not exceed the indebtedness due under the mortgage thereon this should not have prevented the participation by unsecured creditors.

The arrangement provided for in Chapter XII is in the nature of a composition. A debtor comes voluntarily into court and proposes a settlement of his debts with each and every class of his creditors, generally with funds borrowed from friends and relatives. In the present instance debtors proposed settlements or modifications not only of the claims of the bondholders, but also of the claims of other creditors (F. R. 30) by offering a certain percentage in cash. This consideration could effect the hotel property and bondholders neither one way or the other.

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*Unsecured creditors as used in this discussion are unsecured creditors and secured creditors whose claims are subordinate to the Belcrest bonds.

Under the provisions of the statute mentioned above, the debtors' right to come into court and make his offer to the various classes of creditors was unqualified, particularly when the offer to the unsecured creditors was to come from a source other than the Belcrest property. To hold otherwise as the Circuit Court has, would, we submit, defeat the purpose and intent of the entire chapter and would as before stated and as the Circuit Court held, place the debtors in a position where only certain of his debts are discharged and the others will remain outstanding against him. Section 461 requires that an arrangement (1) shall include provisions modifying or altering all rights of creditors secured by real property of debtor, (2) shall provide for the rights of all other creditors of debtor who may be affected by the arrangement. Certainly creditors who are not permitted to participate in the arrangement although the debtor has offered them a consideration are creditors affected by such arrangement. More important, however, is the economically unsound and unwise position in which the debtor is left with undischargeable claims. The district court in such case should either have dismissed the debtor's petition or adjudicated him a bankrupt, whereby he could obtain complete relief.

As the case now stands, petitioner must face the next six years, at least, with over $80,000 of undischarged debts outstanding against him. He is as much "unrehabilitated" now as he ever was. In fact, he is in worse position than if he had filed no petition, because he could have obtained complete relief in ordinary bankruptcy. What then is the use of Chapter XII? None, if the Circuit Court is right. The only construction which will give it any salutary effect is, as petitioner contends, that if a

debtor is unable to reach an agreement with his creditors, then his petition shall be dismissed or he shall be adjudicated a bankrupt, in pursuance of section 481 of the Act.

## III.

### Under Chapter XII of the Chandler Act the Court Cannot Confirm an Arrangement not consented or Agreed to by the Debtor.

Cause No. 8822 in the Circuit Court involved the appeal from the order of confirmation of July 22, 1940. By that order the district court confirmed an arrangement proposed by the Belcrest bondholders' committee which made provision only for their own claims and none whatsoever for other creditors of either debtor. Needless to say, this arrangement was not only not consented or agreed to by debtors, but was vehemently objected to by them. The Court of Appeals, again basing its decision on the fact that the value of the Belcrest property was exceeded by the amount of the debt due thereon, affirmed this order and once again held the rule of absolute priority in corporate reorganization cases applicable. It held (S. R. 45):

> "The statute neither expressly nor by implication provides for consent by the debtor to any arrangement . . . "

But we submit that the requirement of such consent is inherent in the theory and purpose of the chapter. Examination of its provisions discloses:

> A. The Act can be invoked only by the debtor, not by his creditors (Section 421, 422).
>
> B. No arrangement can be confirmed if debtor has done anything which would be a bar to the discharge of a bankrupt (Section 472 (4) ).

C. If an arrangement is not accepted or consummated or confirmation is refused, the court must either dismiss or proceed with bankruptcy (Section 481).

D. If debtor defaults in consummating the confirmed arrangement the same result follows (Section 482).

E. The debtor must make the deposit before the arrangement can be confirmed (Section 468 (2)).

F. The arrangement may make provision for continuing the debtor in business (Section 461 (5) ).

G. If debtor has been guilty of fraud, confirmation may be vacated and debtor adjudicated bankrupt (Section 511 (1) ).

Only on the theory that a debtor's consent is required do these provisions take on significance. With any other construction, they are superfluous. Of course, the statute must be so construed that it shall all have harmonious meaning.

Moreover, being in the nature of an agreement between the debtor and his creditors and partaking of the same nature as compositions, debtor's consent is undoubted. Whether or not such consent is expressly required by the statute is immaterial. There was no such express requirement in the provisions of Section 12 of the old Act, but the court nevertheless required it. In the footnote to *Case v. Los Angeles Lumber Company, supra,* it is said:

> "Consent by the debtor to the composition was implicit in former Sec. 12 (cf. In *re Bryer,* 281 F. 812)."

The Circuit Court in ascertaining the intention of the framers of this chapter resorted to the House Report

of the 75th Congress (S. R. 46). Further examination of these same records will disclose the precise intent of the legislature with respect to the debtor's consent. It is there said (H. R. 1409, 75th Cong., 1st Session, 1937, page 52):

> "Proceedings under this chapter are voluntary only. The debtor must file his plan or arrangement together with his original petition. This clause permits a large creditor or large group of creditors to present proposals thereafter. *While the debtor is in no way bound by such proposals unless he consents to them,* there appears to be no good reason for denying creditors the privilege of submitting a plan of its own." (Italics supplied.)

The Honorable Walter Chandler, member of the 75th Congress and introducer in the House of the Act which now bears his name, has stated the same conclusion in an article in the American Bar Association Journal (Volume XXIV, No. 11, pp. 880, 884):

> " * * * Chapter XII, therefore represents the adjustments of debts secured by real property as well as unsecured debts of those who petition under the Chapter".
>
> "The right is limited to the debtor who may file an original petition or a petition in a pending bankruptcy proceeding if adjudication has not taken place. While the debtor is required to set forth in the petition the terms of his proposal, *his creditors may submit a proposal, which, however, cannot be confirmed unless it is accepted by the debtor*". (Italics supplied.)

Moreover, since Section 423 makes the chapter available to debtors on the ground of insolvency, it is inconceivable that an insolvent will petition for relief if credit-

ors can always force an offer upon him without his consent, particularly since those same creditors cannot institute the proceedings themselves. As stated in 87 University of Pa. Law Review 837, 839:

> "It would be illogical to have involuntary petitions under these chapters (XI and XII), for the debtor may decide to liquidate the business in a straight bankruptcy, whereas an arrangement contemplates its continuation."

Accord that debtor must consent:

> *Collier-Bender Pamphlet Edition,* 1938 Bankruptcy *Act,* p. 300;
> *Moore's Bankruptcy Manual,* p. 722.

The point in question is novel and has not been decided by any other of our courts, although there have been indications in support of our contention.

In *Kunze v. Prudential Insurance Company* (C.C.A. 5, 1939) 106 F. (2d) 917, the debtor's offer was rejected at the creditors' meeting. The court held that it could then only dismiss or adjudicate debtor a bankrupt where no further offer was made by debtor. To the same effect, *Preas v. Kirkpatrick and Burks* (C.C.A., 6, Nov. 9, 1940), C.C.H. par. 52801. In re *Goldstein, supra,* was a proceeding under Section 74 of the Act prior to its amendment. Confirmation of the proposal was there objected to for the reason that it was not for the best interests of creditors. The court held that it could not compel debtor to increase his offer; the only other alternative was adjudication.

Under the Canadian Bankruptcy Law above mentioned it has been expressly held that while creditors were en-

titled to propose amendments, such amendments were not binding upon the debtor until accepted by him. In *Martin v. Riman* (1930) 66 O.L.R. 394, the court said (396):

> "There is a provision in subsec. 1 of sec. 13 for the alteration or modification of the proposal by the creditors at the meeting. *This must necessarily be with the approval of the debtor, but there is no provision enabling the court to vary the proposal. It must either approve or reject the same.*" (Italics supplied.)

So too, in *Re Richardson* (1921) 1 C.B.R. 317, 190 O.W.N. 494, an approval was withheld pending production of further evidence because "The proposal of the debtors was varied by the creditors, and the consent of the debtor to the variation was not shown to have been given."

Most conclusive that debtor's consent to a proposal by creditors is necessary is the provision of Section 472(4), which provides that the court shall confirm an arrangement if satisfied that, among other things, the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt. If the debtor's consent were not required and an arrangement could be imposed upon him against his will, i. e., a reorganization of his assets as distinguished from an arrangement, we are unable to understand the intent and purpose of the provision referred to. If creditors could force through a plan they deemed most beneficial to themselves the conduct of the debtor would be immaterial. The conclusion is inescapable that Chapter XII was inserted in the act for the benefit and protection of the debtors and that relief thereunder should be given to them only if they approve the offer and the court is satisfied from their conduct that they are deserv-

ing. This is strengthened by the fact that this clause, which was formerly a part of Section 12d relating to compositions, has been construed as a *limitation on the power of the court to confirm a composition.*

See: In *Re Godwin* (D. C. Penn., 1903) 122 Fed. 111;
In *Re Comstock* (D. C. R. I., 1907) 154 Fed. 747.

Had Congress felt that the same rule should govern both proceedings under Chapter X and Chapter XII it would certainly have had no occasion for the extensive and elaborate provisions providing for arrangements. It would have been simple to have included under Chapter X voluntary but not involuntary proceedings by individuals. But Congress evidently felt that there was a vital distinction between a reorganization of a corporation and an arrangement of an individual's debts. Such a distinction is readily understandable, because a corporation is an artificial being whose existence is, for all practical purposes, co-extensive with its assets. If those assets are taken away or reorganized, the new or reorganized can begin afresh. As to individuals no such procedure is possible, because their own personal existence continues; their obligations still adhere to them.

## IV.

**A Bondholders' Committee Cannot Propose an Arrangement Prior to a Determination that it is a Creditor and Without Leave of its Controlling Commission.**

Petitioner objected to the proposal by the bondholders' committee because there was not as yet a determination that the committee was a creditor. He also objected on

the ground that the committee had not obtained leave of the Public Trust Commission of the State of Michigan, under whose laws it was organized, to propose and sponsor such a plan.

The district court in its order of February 19, 1940 called the first meeting and provided that "claims of creditors shall be filed in the manner herein provided on or before April 1, 1940" and objections to such claims shall be heard on April 15, 1940 (F. R. 85, 86). Obviously no claims could or would be allowed at least prior to April 1, 1940 and as a matter of fact no claims were allowed until July 22, 1940 (S. R. 22). Until that time there was no adjudication that the bondholders' committee or anyone else was a "creditor". Its attempted offer of an arrangement on July 31, 1939 (F. R. 135) was therefor premature inasmuch as Section 466 provides for the proposals of arrangements approved by *creditors.*

The construction here contended for is the only one that can consistently be applied to this chapter as a whole. As we have repeatedly contended throughout this proceeding and throughout the proceedings in the lower court, the only person who could make an offer prior to the first meeting was the debtor himself. At that meeting the creditors appear, accept or reject the debtor's offer or make an offer of their own. This they can do because at that meeting the court is empowered by Section 436 "to receive proofs of claim and allow or disallow them" and thereby determine whether or not they are creditors. Although the Circuit Court of Appeals upheld our contention that the committee could not propose an arrangement prior to such first meeting, it held somewhat inconsistently that the proposal made by it prior to that time was nevertheless good.

Additional support for our contention will be found in the logical and chronological sequence of the various provisions as set forth in the chapter. Article IV provides for the petition, which must be voluntary, and stay. Article V provides for proceedings subsequent to the filing of the petition such as appointment of trustee, notice to creditors of debtor's offer and first meeting, and procedure at the meeting. Article VI provides in detail for the rights and duties etc. of the debtor and officers. Article VII deals with the creditors and their claims. Article VIII sets forth the provisions of an arrangement. Article IX now for the first time mentions the rights of creditors to propose amendments or modifications. Its very position in the chapter and its relation to the other parts thereof can lead but to the one conclusion that these rights of the creditors can be exercised only at or after the first meeting, and at or after the allowance of their claims.

The procedure taken by the district court was found by the Circuit Court of Appeals to be erroneous, but not prejudicial. We submit that the procedure taken effectively destroyed the statutory rights of the debtors to submit their offer to their creditors on an uncompetitive basis, unaccompanied by a canceling order of the court precluding their participation.

Furthermore objection was made to the confirmation of the proposal by the bondholders' committee because by the laws of the State of Michigan (Act No. 89 P.A. 1933, as amended) under which it was organized, it was first required to obtain leave of the Public Trust Commission created by that Act, to sponsor or propose the arrangement. Pertinent sections of the statute are set forth in Appendix B hereof.

Section 2(d) defines a protective committee so as to include the one presently involved. Section 3 requires that any person acting as a member of such committee shall first procure a license. Section 10 provides that "no protective Committee . . . shall take any action either by suit or otherwise . . . against either the property and/or business with respect to which said security was issued and/or against the person or persons who executed the security *unless and until authority to take such action has been conferred upon the protective committee by the commission.*"

Section 10 then further provides that if any committee desires to take such action it shall file application with the commission upon which the commission shall enter an order fixing the time and place for hearing. Section 19 provides that any person who violates the provisions of Section 10 shall be punished by a fine of not less than $500.00 or by imprisonment or both.

The record shows that no application was filed by the committee with the Public Trust Commission for leave to propose or sponsor the arrangement. Subsequently, at or about the time of the confirmation, the committee did obtain a letter from the Commission disclaiming jurisdiction and at the same time approving the procedure already taken. Aside from the obvious inconsistency of such action of the Commission, the belated approval was without legal effect. If there was no authority in the first instance to proceed it could not be cured, *post facto.*

By virtue of the statute above quoted the state has placed protective committees under its supervision and control and has required them to be licensed, and obtain leave to act. Like corporations they are made creatures

of the sovereign power and their authorities and duties depend upon the laws and statutes of that sovereign. The property being located in the State of Michigan and the committee having been organized and licensed under the laws of that state, those laws must control its powers and existence. (See *Chicago Title & Trust Company v.* 4136 *Wilcox Building Corporation,* 302 U.S. 120, 127; 6 *Fletcher Encyclopedia of Corporations* (Perm. Ed.) Section 2477, pages 176, 180).

The principle laid down in the *Chicago Title & Trust Company* case, *supra,* is directly applicable to the instant case. There a corporation which had been dissolved under the laws of the State of Illinois attempted to file a voluntary petition for reorganization under 77B. This Court held that it was without authority to do so saying:

> "The conclusion seems inevitable that if the state attach qualifications to its sentence of extinction nothing can be added to or taken from these qualifications by federal authorities" (128).

So in the instant case the state which has created the protective committee has in specific terms decreed that before any action can be taken, leave must be obtained from the Public Trust Commission upon application duly filed and heard. Without such permission, the committee has no more power to proceed than had the defunct corporation which attempted to reorganize itself. There was no power to invoke the jurisdiction of the federal court in either instance. We submit that the arrangement proposed by the bondholders' committee was a nullity because it was premature and without leave of the Public Trust Commission of the State of Michigan.

## V.

## CONCLUSION

Considerable comment has been made that to hold that a debtor's consent is required before an arrangement is confirmed, leaves him in control of the proceedings which he can then use for dilatory purposes. But our theory of the chapter permits no such results. If debtor's offer is promptly sent out to creditors and a first meeting called as the statute says, it will either be accepted or rejected in less than two months. If accepted it will forthwith be confirmed; if rejected, the petition is dismissed or debtor is adjudicated a bankrupt and relieved of all his debts as required by section 481. Delay in the instant case was occasioned by the fact the committee and another intervened and sent out their offers to creditors with debtors', which the Circuit Court held was error.

Recapitulating the contentions of petitioner, we submit: (1) that an arrangement is a composition, and a debtor, even if insolvent, may still propose a "fair and equitable" offer if it confirms to creditors as much as they would get upon liquidation; (2) that in any event, debtor should be allowed to settle his claims with unsecured creditors; (3) that no offer made by and for only one class can be confirmed without debtor's consent, leaving him with other claims undischarged; and (4) the committee's arrangement was void because premature and made without leave of the Public Trust Commission.